

REGULATORY INFORMATION BULLETIN

RBE-03-12
December 19, 2003

TO: All ETP Holders

FROM: Regulation Division

SUBJECT: PCXE Member Awareness Session December 17, 2003

Part I - ETP Holder Obligations regarding the PCXE Disciplinary Process

PCX Equities, Inc. ("PCXE") hereby advises all ETP Holders of their obligations in association with the PCXE Disciplinary Process.

Disciplinary Jurisdiction and Regulatory Cooperation

PCXE Regulation has the discretion to investigate, and will investigate, possible violations that occur on ArcaEx and are within the disciplinary jurisdiction of the Corporation. See PCXE Rule 10.2(a).

All ETP Holders are subject to the disciplinary jurisdiction of PCXE and must cooperate with the investigation by furnishing testimony, documentary materials or other information requested by the PCXE during the course of an investigation. See PCXE Rule 10.2(d).

Any ETP Holder or associated person of an ETP Holder who is alleged to have violated or aided and abetted a violation of any provision of the Securities Exchange Act of 1934 or PCXE Rules is subject to the disciplinary jurisdiction of the PCXE. See PCXE Rule 10.1.

As PCXE has jurisdiction over ETP Holders, it may not have jurisdiction over customers of ETP Holders. ETP Holders are responsible for collecting information from the customers they provide access to on the ArcaEx. Investigations that involve customers of ETP Holders may also be referred to the SEC or the individual's DEA for disciplinary action.

ETP Holders Investigation Correspondence Guidelines

ETP Holders must cooperate with investigations by furnishing testimony, documentary materials or other information requested by the PCXE during the course of an investigation.

ETP Holders are responsible for collecting information from the customers they provide access to on the ArcaEx.

PCXE has established the following investigation correspondence guidelines in accordance with PCXE Rule 10.2:

- For ETP Holders that are subject to an investigation, an initial request letter will be sent to the ETP as a Request for Information in association with an investigation. ETPs will have **15** business days to respond.
- If the ETP Holder does not submit a response by the due date, PCXE will send a 2nd request for information with a copy of the original request letter with a reference to the PCXE Rule 10.2 (d), the PCXE's Failure to Cooperate provision. ETPs will have **10** business days to respond.
- If the ETP Holder does not submit a response by the due date, PCXE will send a 3rd and final request for information with a reference to PCXE's FTC provision. ETPs will have **5** business days to respond.
- If the ETP Holder does not submit a response by the due date, PCXE will send a Wells Letter¹ for violation of PCXE Rule 10.2(d) with **10** business days to respond.
- If no response is received, Equities Surveillance Department (ESD) staff will refer the matter to PCXE Enforcement or the SEC for failure to comply with PCXE Rule 10.2(d).
- Extensions may be granted, in certain circumstances, at the discretion of PCXE Regulation. To request an extension, it must be submitted to the investigator in writing and before the due date. All extensions will be reviewed by ESD Management.

Please note that these are guidelines and PCXE Regulation maintains the discretion to make requests for information requiring shorter response times. PCXE Regulation further maintains the discretion to make additional requests for information as required by the investigation. Those requests will be subject to these guidelines and PCXE Rules.

Policy on Failure to Cooperate with an Investigation

Pursuant to PCXE Rule 10.2(d), ETP Holders that impede or delay a regulatory investigation by refusing to furnish testimony, documentary materials or other information requested by the PCXE during the course of its investigation, will be subject to formal disciplinary action. This provision also includes failure to furnish information or testimony requested on the date or time period required by the PCXE. ETP Holders that do not cooperate will be considered to be obstructive of the inquiry or investigation and subject to formal disciplinary action.

¹ A "Wells Letter" will usually be issued to an ETP Holder or associated person prior to any investigation being forwarded to Enforcement. A Wells Letter states the rules that may have been violated and allows the addressee an opportunity to respond to those allegations in writing. Although there is no requirement under Exchange rules to respond to a Wells Letter, Regulation staff strongly encourages a response. A response can help clarify facts or circumstances that may narrow or address issues and assist in the member's defense.

Minor Rule Plan Schedule for Failure to Cooperate with an Investigation

Outlined below is the fine schedule for delaying, impeding or failing to cooperate with an investigation:

First violation:	\$3500.00
Second violation:	\$4000.00
Third violation:	\$5000.00

See PCXE Rule 10.12 for schedule.

Please note that nothing in this schedule requires the PCXE to impose a fine for a violation of any Rule under this Minor Rule Plan. If PCXE Regulation determines that any violation is not minor in nature, PCXE Regulation may, at its discretion, proceed under Rule 10.4. See PCXE Rule 10.12 (f).

ETP Holders Must Supervise Access to ArcaEx

Each ETP Holder must establish, maintain and enforce written procedures to supervise its business and the activities of its associated persons that are reasonably designed to achieve compliance with applicable federal securities laws and regulations and PCXE Rules. See PCXE Rule 6.18.¹

Part II - Odd Lot Abuses

General Provisions

Pursuant to PCXE Rule 7.38 and PCXE Regulatory Information Bulletin Number 03-10, PCXE Regulation clarified prohibited odd lot trading activities that may be deemed violations of PCXE Rules, specifically:

- Odd Lot Abuse and the Demonstrably Erroneous Execution Policy. See PCXE DEE Policy.
- Failure to aggregate odd lot orders into round lot orders. See PCXE Rule 7.38 (c)(3).
- Unbundling of round lots for the purposes of entering odd lot limit orders in comparable amounts. See PCXE Rule 7.38 (c)(2).
- Odd lot abuse, i.e., odd lot trading or patterns that are indicative of an abusive strategy to take advantage of unusual market conditions, at the expense of other market participants. See PCXE Rule 6.2 (b).

These prohibitions are applicable to all sessions of trading on ArcaEx.

Odd Lot Abuse and the Demonstrably Erroneous Execution Policy

- PCXE reserves the right to break odd lot trades that are determined to be for the same beneficial user or owner. For complaints received in a timely manner by harmed parties, the PCXE reserves the right to bust the trades when it is determined that the same beneficial user was submitting multiple odd lots in a short period of time.
- If beneficial ownership cannot be quickly established by the ArcaEx trading operations desk, PCXE Regulation will work with the ETP firm's compliance department to determine who the beneficial owner is before breaking any trades.
- This type of activity could also result in an investigation of the trading activity and potential disciplinary action. Concurrently, PCXE will conduct automated surveillance reviews for potentially abusive odd lot trades and if suspicious activity is detected, an investigation will be initiated.

Clarification on Odd Lot Trading Prohibitions

When done for legitimate purposes, ETP Holders are not specifically required to aggregate odd lots for different types of accounts owned by the same beneficial owner. Examples include:

- 30 shares in margin account and 70 shares in a cash account
- 65 shares for an IRA and 80 shares for a regular account

However, if the intent for failure to aggregate was to participate in manipulative wash trading scheme or for illegal tax purposes, the trading will be investigated and, if appropriate, referred to the SEC. Examples of potential predatory or manipulative activity by failing to aggregate odd-lots or unbundling of rounds lots are:

- Execution of numerous odd lot trades that add up to a significant volume of a security with the intention of closing or opening a position without the knowledge of other market participants. That is, failing to aggregate orders by a user who does not want his or her activity to hit the tape.
- The entry of multiple odd lot orders to obtain automatic execution against an odd lot dealer, especially when the NBBO is locked or crossed.
- Entry of odd lot orders during the pricing of auctions with the intent of manipulating the auction price. Use of odd-lots to affect the auction price could be indicative of manipulation and could result in a formal investigation.
- Unbundling of round lot orders into odd-lot orders during any trading session to attempt to transfer securities between the accounts of the same beneficial owner may result into an investigation.

For more information

For more information on written supervisory procedures, see *Supervision Obligations of ETP Holders*, PCXE Regulatory Information Bulletin Number 02-02.

For more information on odd lot abuses, see *Odd Lot Orders – Prohibitions*, PCXE Regulatory Information Bulletin Number 03-10.

For more information on the DEE Policy, see the Archipelago Website (listed below).

For more information on the rules covered at the Member Awareness Session, please see the PCX Website or the Archipelago Website:

<http://www.pacificex.com> listed under *PCX/PCXE Rules*

<http://www.archipelago.com> listed under *The Exchange/Regulation/Exchange Rules*

Contact information

If you have any questions regarding the contents of this bulletin, please contact Jill Persson, Director, Equities Market Regulation at (415) 393-7847 or John Chapin, Director, Equities Surveillance (312) 442-7790. Inquiries can also be made to the PCXE Surveillance Hotline at (312) 442-7788 or general surveillance questions can be addressed via email to surveillance@archipelago.com.

About the PCX

The Pacific Exchange, Inc. (“PCX”) is the self-regulatory organization responsible for regulating all activity that takes place through the Archipelago Exchange (“ArcaEx”), a facility of the PCX. The PCX has delegated its self-regulatory authority for ArcaEx to PCXE, a wholly-owned subsidiary of the PCX. The Regulation Division of PCXE conducts surveillance, examinations, and enforcement to seek compliance by ETP Holders and associated persons with the PCX Constitution, the rules of PCXE, and federal securities laws.